

General Information Letter: Mere statement of how separate accounting reaches a tax result different from statutory apportionment method is insufficient to grant petition to use alternative method of apportionment.

July 27, 1999

Dear:

This is in response to your letter dated June 8, 1999 in which you request permission to use an alternative method of allocation or apportionment. Department of Revenue ("Department") regulations require that the Department issue only two types of letter rulings, namely, the Private Letter Rulings ("PLR") and General Information Letter ("GIL"). A PLR is issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding against the Department, but only as to the taxpayer who is subject to the request for ruling and only to the extent the facts recited in the PLR are correct and complete. A GIL does not constitute a statement of Department policy that applies, interprets or prescribes the tax laws and is not binding against the Department. See 2 Ill. Adm. Code 100.1200(b) and (c).

Although a ruling granting an alternative allocation or apportionment has been requested, since the petition fails to sustain the burden of proof required pursuant to 86 Ill. Adm. Code 100.3390 (copy enclosed) the Department must respond by GIL denying the petition.

In your letter you have stated as follows:

This Petition for Alternative Allocation or Apportionment under Illinois Administrative Code Section 100.3390 (IITA Section 304(f)) relates to the above referenced wholly owned subsidiary of xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx (the xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx), EIN xxxxxxxxxx.

The application of the Illinois' statutory formula leads to a grossly distorted result of the Illinois based subsidiary. Separate accounting is utilized for the parent corporation and each of its seven wholly owned subsidiaries. We have enclosed preliminary schedules that show the results of each corporation, and the grand totals for a consolidated federal tax return.

We have also enclosed a preliminary Illinois Department of Revenue Form IL-1120 and the related Schedule UB for the tax year ended February 28, 1999. As you can see, Form IL-1120 (Part IV, Page 2, Line 1) shows a "Base income (loss)" for Illinois of \$3,958 (loss). In reality, the Illinois subsidiary loss for this period was \$189,918 (loss), as can be substantiated by the supporting federal schedule of income (copy enclosed).

Since this clear and cogent evidence proves that the statutory formula results in the taxation of extraterritorial values and operates unreasonably and arbitrarily in attributing to Illinois a percentage of income which is out of all proportion to the business transacted in Illinois, we ask that the alternative allocation or apportionment of separate accounting (IL Section 100.3390, a) be approved.

RULING

Where the activities of a taxpayer in Illinois form part of a unitary business that extends into other states, the Illinois Income Tax Act (the "IITA"; 35 ILCS 5/101 et seq.) requires that the income generated by those activities be apportioned under a three-factor formula (IITA §304(a)). This formula compares the taxpayer's Illinois and aggregate property, payroll, and sales (See Id.). Illinois rejects the separate or geographical accounting method in such circumstances since that method "is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise." (Container Corporation of America v. Franchise Tax Board, 463 U.S. 159, 164-65, 103 S.Ct. 2933, 2940 (1983)). Thus, the formula apportionment method is used, which focuses upon objective measures of a taxpayer's activities within and without the State (Id.)

At the same time, formula apportionment may not be applied without exception. The factors used in the apportionment formula must actually reflect, in each individual case, a reasonable sense of how income is generated (Id. at 2942). And where the apportionment formula does not so reflect, a fair and accurate alternative method is appropriate (86 Ill. Adm. Code 100.3390(c)). Accordingly, IITA section 304(f) allows the taxpayer to petition the Director for an alternative apportionment method, including separate accounting, where the statutory method does not fairly represent the extent of the person's business activity in Illinois.

Consistent with these principles, Illinois Income Tax Regulations section 100.3390(c) sets forth the taxpayer's burden under section 304(f) as follows:

A departure from the required apportionment method is allowed only where such methods do not accurately and fairly reflect business activity in Illinois. An alternative apportionment method may not be invoked ... merely because it reaches a different apportionment percentage than the required statutory formula. The party ... has the burden of going forward with the evidence and proving by clear and cogent evidence that the statutory formula results in the taxation of extraterritorial values and operates unreasonably and arbitrarily in attributing to Illinois a percentage of income which is out of all proportion to the business transacted in the state. In addition the party ... must go forward with the evidence and prove that the proposed alternative apportionment method fairly and accurately apportions income to Illinois based upon business activity in this State.

Regulations section 100.3390(d) adds:

A petition will be summarily rejected if its sole basis for support rests on the fact that an alternative method reaches a different apportionment percentage than the required statutory formula.

These provisions indicate the taxpayer's burden under IITA section 304(f) to be two-fold. It must be shown not only that the alternative method proposed results in a fair allocation, but also that application of the statutory method results in an unfair allocation. Moreover, because separate or geographical accounting does not fully reflect the value-producing factors of a unitary business, the

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second aspect of the taxpayer's burden is not satisfied merely by showing that separate or geographical accounting results in an allocation that differs from the statutory method. Thus, a petition supported solely by the allocation arrived at under the separate or geographical accounting method must be rejected since it fails to reveal any defect or unfairness in applying the factors relied upon by the apportionment formula to approximate where business income has been derived.

In this case, the petition contains as its sole support an allocation under the separate or geographical accounting method that differs from the allocation arrived at by application of the three-factor apportionment formula. The petition argues only that the formula method overstates Illinois income while the separate or geographical accounting accurately reflects Illinois income. Hence, the petition must be rejected pursuant to Illinois Regulations section 100.3390(d).

As stated above, this is a GIL which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department.

Sincerely,

Paul Caselton
Deputy General Counsel - Income Tax